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COMMONWEALTH OF VIRGINIA, ex rel.

STEPHEN M. TURNER, et al.

v.

CASE NO. PUE990002

**AUBON WATER COMPANY,
Defendant**

REPORT OF MICHAEL D. THOMAS, HEARING EXAMINER

September 27, 1999

HISTORY OF THE CASE

On November 5, 1998, Aubon Water Company (the "Company") filed a Notice of Rate Increase with the Commission's Division of Energy Regulation, pursuant to the Small Water or Sewer Public Utility Act (Va. Code §§ 56-265.13:1 et seq.). The Company proposed to make the rate increase effective for service rendered on and after January 16, 1999. The Company proposed the following rates to cover its current level of expenses and cover the cost of constructing a water treatment facility for one of its water systems:

	<u>Current Rates¹</u>	<u>Proposed Rates</u>
1. Service Connections	\$475.00	\$950.00
2. Water Rates:		
a. first 3,000 gallons (per 1,000 gallons)	\$2.50	\$5.00
b. over 3,000 gallons (per 1,000 gallons)	\$3.50	\$6.00
3. Minimum Charge	\$7.50	\$15.00

On January 13, 1999, the Commission entered a Preliminary Order wherein the Commission took judicial notice of an Order of Settlement entered by the Commission on December 16, 1998, in Case No. PUE980628.² The Commission also suspended the Company's proposed rate increase

¹The Company's current rates were placed into effect on July 8, 1983, in Case No. PUE830015.

²The Order of Settlement required the Company to take certain remedial measures to improve the quality of the water for its customers in the Long Island Estates subdivision. The measures involved installing a water treatment facility to remove iron and manganese from the subdivision's water system. The Company estimated the cost of the treatment facility to be between \$50,000 and \$60,000. The Order of Settlement further required the Company to meet certain deadlines for the design and construction of the water treatment facility.

through March 8, 1999. After that date, the Company's rates were made interim and subject to refund, with interest. Pursuant to § 56-265.13:6 of the Code of Virginia, the Commission ordered a hearing on the Company's proposed rate increase.

On February 12, 1999, the Commission entered an Order of Notice and Hearing wherein the Commission appointed a Hearing Examiner to conduct a hearing on April 20, 1999, to receive evidence on the Company's proposed rate increase. The Commission's order established a procedural schedule for the Company to provide notice of the hearing to its customers and for the prefiling of testimony and exhibits by the Company and the Commission's Staff.

By letter dated March 17, 1999, the Company notified the Commission's Staff that, for no good reason, it had missed the deadline set forth in the Commission's February 12th order for sending notice of the hearing to its customers. In addition, the Company failed to file any direct testimony or exhibits in support of its request for an increase in water rates.

By Hearing Examiner's Ruling entered on March 23, 1999, the procedural schedule for the case was revised to permit the Company another opportunity to file testimony and exhibits in support of its rate request, and to provide its customers the required notice of public hearing. The hearing was rescheduled for June 22, 1999.

At the appointed time on June 22, 1999, this matter came on for hearing. The Company appeared *pro se*, by its president, G. Ray Boone. The Commission's Divisions of Energy Regulation and Public Utility Accounting (the "Staff") appeared by their counsel Don R. Mueller, Esquire. Carl W. Anderson, a resident of the Long Island Estates subdivision, appeared as a public witness at the hearing. A transcript of the hearing is filed with this Report.

SUMMARY OF THE RECORD

The Company has four separate water systems that serve 255 metered customers. The systems serve the Hillcrest, Franklin Heights, Alton Park, and Long Island Estates subdivisions located in Franklin County Virginia.³ The Hillcrest system is comprised of one well and two storage tanks, and it serves 16 customers. The Franklin Heights system is comprised of four wells and two storage tanks, and it serves 142 customers, although it was designed to serve 130. The Alton Park system consists of one well and two storage tanks, and it serves 39 customers, although it was designed to serve 24. The Long Island Estates system consists of three wells and two storage tanks, and it serves 58 customers, although it was designed to serve 46. (Ex. GA-6, at 2-3).

All of the systems suffer from lack of capacity or poor water quality. The worst system in terms of water quality is the one located in Long Island Estates. This system has been plagued with water problems since the time the system was installed. One of the wells serving the subdivision had to be abandoned because of poor water quality. The water from the wells is extremely hard and contains excessive amounts of iron and manganese. The water meets current state and federal

³ The Hillcrest, Franklin Heights, and Alton Park subdivisions are located in and around Rocky Mount, Virginia. The Long Island Estates subdivision is located 15 to 20 miles away on Smith Mountain Lake.

drinking water standards except for the high concentration of these minerals. The iron and manganese in the water pose no health problems, but may have an adverse impact if used in beverages such as coffee or tea and may stain plumbing fixtures and clothes. As a result of recent customer complaints concerning the quality of their water, the Virginia Department of Health (“VDH”) and the Staff initiated action against the Company, which resulted in the Commission’s December 16, 1998, Order of Settlement. (Ex. GA-6, at 4; Ex. RB-1, at 1; Ex. RB-1, Attachments 6, 7 and 8).

Mr. G. Ray Boone, the Company’s president, testified on behalf of the Company. Mr. Boone testified the Company does not have the working capital to construct the water treatment facility. He testified the Company applied for an \$80,000.00 commercial loan from First Virginia Bank in Rocky Mount, Virginia, to finance the construction of the facility. First Virginia Bank has conditioned the loan on the Company resolving an issue involving annexation of the Franklin Heights subdivision by the Town of Rocky Mount. The Town of Rocky Mount and Franklin County reached an agreement on the annexation of 500 acres of land adjoining the Town, including the Franklin Heights subdivision. The Town has indicated it intends to provide water and sewer service to Franklin Heights within three years. Mr. Boone has heard the Town intends to run a parallel system to his system and not purchase his system. Residents in the subdivision would have the option of staying on the Company’s system or connecting to the Town’s system. Mr. Boone contacted the town manager, the mayor, and a member of the town council concerning this case, but the only response he received was that the lawyers would take care of it. The Commission on Local Government and the Virginia Supreme Court have not yet approved the annexation. Mr. Boone testified the loan requested by the Company might not be sufficient to cover the entire cost of the facility. The most recent information from the Company’s engineers indicates the cost of the facility may exceed \$90,000. The Company applied for a loan from the VDH Drinking Water State Revolving Fund Program for Fiscal Year 2000, to fund the construction of the water treatment facility.⁴ (Exs. RB-1, at 2; RB-3; RB-4; Tr. at 11, 15, 21-22, 26-32, 41-42).

Mr. Boone expressed some concern with the cost of the facility as it relates to the number of customers served in Long Island Estates. The Staff’s prefiled testimony indicated 58 connections in this subdivision. Since the time the testimony was filed, three of the Company’s customers have drilled their own wells and disconnected from the system, and two others have drilled their own wells but have not disconnected from the system. He has heard rumors that three other customers have contracts to drill wells. Mr. Boone is also concerned that, if his rates are too high because of the cost of the water treatment facility, other customers may drill their own wells and he may be left with a water treatment system and no customers. (Ex. RB-2; Tr. at 17-18, 20, 23).

Mr. Boone opposes the three-tiered rate schedule proposed by the Staff. He does not agree that the three-tiered rate would promote water conservation any more than a two-tiered rate. On cross-examination, Mr. Boone testified the Company would not incur any additional expense if it changed to a three-tiered billing schedule. (Tr. at 23-26).

⁴ The Virginia Department of Health advised the Company by letter dated July 28, 1999, that it did not make the tentative list of projects. The Company was encouraged to apply again next year. *See*, Document Control Number 990810036, Case No. PUE990002.

The Company expects its final plans for the construction of the water treatment facility to be approved by September 15, 1999. The Company must conduct a drawdown test on one of its Long Island Estates wells before the VDH will consider the final plans. (Tr. at 32-38).

Finally, Mr. Boone expressed his hope the Company does not go bankrupt in this process. (Tr. at 43).

One public witness appeared and testified. Carl W. Anderson, a resident of Long Island Estates, testified that he had spoken with a number of his neighbors and they are not opposed to a rate increase as long as there is something done with the quality of their water. He would prefer the cost of the water treatment facility to be spread among all of the Company's customers. (Tr. 44-49).

The Staff's first witness was Ashley W. Armistead, Jr., principal public utility accountant with the Commission's Division of Public Utility Accounting. Mr. Armistead made a number of adjustments to the Company's per book numbers. These included: (1) annualizing water revenue based on the number of metered customers served at the end of the test year which increased revenues by \$691; (2) removing certain non-recurring expenses which reduced expenses by \$617; (3) capitalizing two expenses related to pump improvements which reduced expenses by \$1,181; (4) calculating an eight-year average for hauling water to Alton Park and Franklin Heights subdivisions which decreased the test year expense by \$346; (5) disallowing certain truck and repair costs in the Company's billing expense which decreased O&M expense by \$180; (6) amortizing the Company's proposed \$1,401 rate case expense over two years; (7) correcting a billing error which increased management service expense by \$144; (8) allowing a 3% composite rate of depreciation on gross year end plant balances which increased depreciation by \$677; (9) annualizing amortization of contributions in aid of construction ("CIAC") which increased the amortization by \$579; (10) adjusting amortization expense to allow a one-year amortization of the utility plant acquisition adjustment for the Hillcrest subdivision; (11) reducing gross receipts taxes by \$100 based on the Company's adjusted revenues; (12) allowing a tank not in service to be included in materials and supplies; (13) allowing one-ninth of adjusted operations and maintenance in rate base as working capital; (14) adding utility additions to the original cost of plant which increased utility plant in service by \$70,117; (15) increasing CIAC for connection fees not booked in prior years by the amount of \$16,791; (16) reclassifying a \$2,500 prepaid line extension to CIAC; (17) correcting accumulated depreciation on gross depreciable plant to \$40,830; (18) correcting accumulated amortization of CIAC to \$7,136; and (19) allowing the \$1,521 unamortized portion of the original acquisition adjustment for the Hillcrest subdivision in rate base. These adjustments produced the Staff's recommended revenue requirement for the Company of \$41,274, which produces adjusted operating income of \$6,054 and a 17.30% return on rate base of \$35,001. (Ex. AA-5, at 4-12).

Mr. Armistead also made several general recommendations. First, the Company should collect two \$4,000 no-interest loans made to Mr. Boone and a business owned by his daughter. Second, the Company should transfer a prepaid water main extension from its prepaid account to CIAC. The ten-year period for refunding the prepayment expired in 1998. The prepayment is now the property of the Company. Third, the Company should maintain its books in accordance with the Uniform System of Accounts for Class "C" Water Utilities. Finally, the Company should

depreciate plant and amortize contributions at a three percent composite rate. (Ex. AA-5, at 3-4, 11).

In response to the Company's rebuttal testimony, Mr. Armistead prepared a revised Rate of Return Statement to reflect the loss of the three customers who drilled their own wells and disconnected from the Company's system. In addition, Mr. Armistead clarified for the record that the Staff's recommended rate increase did not include any funds for the construction of the water treatment facility at Long Island Estates. The last two columns of the revised Rate of Return Statement, showing the impact of the water treatment facility on the Company's rates, were provided only for informational purposes. (Ex. AA-5, Statement IV-Revised; Tr. at 56-58).

In response to questioning from the bench, Mr. Armistead testified the Commission approved a stepped rate increase for a water company in the past.⁵ In that case, the company was able to collect the interest expense on a loan during the construction phase of a water treatment facility and when the facility was completed the remainder of the rate increase was placed into effect. Mr. Armistead further testified another reasonable alternative would be to place the difference between the Staff's recommended revenue increase and the Company's requested revenue increase in an escrow account. The difference represents the revenue required to pay the costs associated with the water treatment facility. (Tr. at 59-60).

The Staff's second witness was Gregory L. Abbott, a utilities specialist with the Commission's Division of Energy Regulation. Mr. Abbott confirmed the quality of service and lack of capacity problems experienced by the Company. He also confirmed customer response to the proposed rate increase was significant. He testified the Company's customers could be placed in two groups. Those that live in Long Island Estates do not want to see a rate increase until the Company installs the water treatment facility. Those that live in the Hillcrest, Franklin Heights, and Alton Park subdivisions do not want their rates increased to pay for a water treatment facility to benefit Long Island Estates. Mr. Abbott testified the Company's proposed rates result in a substantial increase to all users, with minimum use water customers bearing a disproportionate share of the increase. Under the Company's proposed rates the minimum use customers would see a 100% increase in their rates while higher use customers would see a 75% increase in their rates. Based on an average monthly usage of 3,500 gallons, a typical customer's monthly bill would increase from \$9.25 to \$18.00. (Ex. GA-6, at 3-4, 6-7).

Based on Mr. Armistead's proposed revenue requirement of \$41,274, Mr. Abbott recommended the Commission approve an increase of \$3,752 in annual revenues to cover the Company's increased operational expenses. Mr. Abbott's recommended revenue increase does not include any of the costs associated with the water treatment facility. It is Staff's position that any rate increase designed to recover the costs associated with the water treatment facility should be contingent upon the Company completing construction of the facility. Mr. Abbott also recommended the Company adopt a three-tiered rate to address the Company's capacity problems

⁵ See, *SCC v. Thomas Bridge Water Corporation*, Case No. PUE940010, 1995 S.C.C. Ann. Rep. 295.

and promote water conservation. The Staff proposed the following rates to meet its recommended revenue requirement:

	<u>Monthly Rate</u>
First 3,000 gallons	\$8.00
3,001-8,000 gallons, per 1,000 gallons	\$4.00
Over 8,000 gallons, per 1,000 gallons	\$5.25

Ex. GA-6, at 7-8, 10; Tr. at 63-66.

Mr. Abbott testified the Staff is keenly aware of the difficult position in which the Company finds itself. The Company is under a Commission order to improve its Long Island Estates water system. If the Commission denies the Company's requested rate increase, First Virginia Bank will not loan the Company the money to make the Commission ordered improvements to the system. As a result, the Company would be in violation of the Commission's Order of Settlement. (Ex. GA-6, at 9).

If the Commission decided to grant the Company's proposed rate increase, Mr. Abbott proposed two potential rate designs for Commission consideration. The first involved a single-tariff rate design. In this rate design, the cost of the water treatment facility would be spread equally among all of the Company's customers. The Staff recommended the following rates for this rate design:

	<u>Monthly Rate</u>
First 3,000 gallons	\$14.00
3,001-8,000 gallons, per 1,000 gallons	\$6.50
Over 8,000 gallons, per 1,000 gallons	\$9.00

Based on the Company's overall average monthly usage of 3,500 gallons, a typical customer's bill would increase from \$9.25 to \$17.25.⁶ Unlike the Company's proposed rates, this rate design shifts more of the cost of the rate increase from minimum use customers to higher use customers. (Ex. GA-6, at 11-12; Tr. at 64-65).

The second rate design offered for consideration by the Staff provides for separate rate classes. The Company's customers would be divided into two rate classes, with the customers in Hillcrest, Franklin Heights, and Alton Park in one class and the customers in Long Island Estates in the other. The customers in Long Island Estates would bear the entire cost of the water treatment

⁶ The Company's average monthly usage varies among its water systems. The average monthly usage for Hillcrest, Franklin Heights, and Alton Park is 3,300 gallons. The average monthly usage for Long Island Estates is 4,000 gallons. This produces a Company-wide average of 3,500 gallons.

facility in their rates. If this rate design were adopted, the Staff proposed the following rates for the Company's customers in the Hillcrest, Franklin Heights, and Alton Park subdivisions:

	<u>Monthly Rate</u>
First 3,000 gallons	\$9.00
3,001-8,000 gallons, per 1,000 gallons	\$4.20
Over 8,000 gallons, per 1,000 gallons	\$5.40

Based on the average monthly usage of 3,300 gallons for customers in this class, a typical customer would see his monthly water bill increase from \$8.55 to \$10.26. The Staff proposed the following rates for Long Island Estates:

	<u>Monthly Rate</u>
First 3,000 gallons	\$37.50
3,001-8,000 gallons, per 1,000 gallons	\$8.50
Over 8,000 gallons, per 1,000 gallons	\$10.50

Based on the average monthly usage of 4,000 gallons for customers in this class, a typical customer would see his monthly water bill increase from \$11.00 to \$46.00. (Ex. GA-6, at 12-14).

Mr. Abbott discussed the pros and cons of each rate methodology. The single-tariff rate design would mitigate the rate shock that would be imposed on the customers living in Long Island Estates. However, this rate design results in one group of customers subsidizing another. For the Company, this subsidization among its various water systems is nothing new. Mr. Abbott testified the Staff's analysis of the Company's test year cost of service indicates the customers in Long Island Estates subsidized the other systems. He testified this subsidization might have occurred in years prior to the test year. He further testified the single-tariff rate design is consistent with the Company's past operating practices and is consistent with the rate design methodology the Company proposed in this case. In contrast, he testified the most compelling argument in favor of establishing two separate rate classes is to avoid subsidization of one group of customers by another. He testified this type of rate design is often appropriate where the two classes of customers have drastically different cost structures. He testified the responses received from the customers in Hillcrest, Franklin Heights, and Alton Park indicate they are acutely aware of this issue. (Ex. GA-6, at 14-15).

Mr. Abbott reiterated the Staff's position that the Commission should not approve a rate increase designed to recover the cost of the water treatment facility until the facility has been built and placed in service. Mr. Abbott testified there are two areas of uncertainty that need to be addressed before such a rate increase should be approved. The first is the cost of the facility. The Company's notice for a rate increase indicates the cost of the facility will be \$60,000. The preliminary engineering report estimates the cost to be \$71,697. The most recent engineering report estimates the cost at \$99,038. The second area of uncertainty is the proposed annexation of Franklin Heights by the Town of Rocky Mount. One of the conditions of the loan commitment from First Virginia Bank requires the Company to execute an agreement with the Town of Rocky Mount providing that the Company will be the sole water provider to Franklin Heights for the life of

the ten-year loan, or the Town must agree to pay the Company an amount equal to or greater than the loan amount for the Company's Franklin Heights water system. (Ex. GA-6, at 16-18).

Mr. Abbott also made several general recommendations in his testimony. These included: (1) the Company's requested increase in its service connection charge should be denied; (2) the Company should be required to change the rates in its tariff from monthly to bimonthly to coincide with the Company's bimonthly billing cycle; and (3) the Company should clearly state in its tariff the rates that apply to multi-unit connections. (Ex. GA-6, at 18-20).

DISCUSSION

This case presents a number of challenges for the Commission. The Company's long-standing problems with its Long Island Estates water system are well documented on this record. The Company is under a Commission Order of Settlement to construct a water treatment facility for this water system. The Company does not have the internal working capital to construct the facility. Therefore, it must look to outside sources to finance the construction. The Company did not qualify for the VDH's revolving loan program for this year and it is doubtful the Company may ever qualify. The water at Long Island Estates may taste bad and it may damage clothes and plumbing fixtures, but it does not pose a health hazard to the Company's customers. The VDH prioritizes applications for the revolving loan program based on whether there is a health risk to the public, not whether the water tastes bad. Without financing from the VDH, the only other option available to the Company to comply with the Commission's Order of Settlement is to secure construction financing from a commercial lender.

The Company obtained a loan commitment for an \$80,000 ten-year commercial loan at an interest rate of 8.75% from the First Virginia Bank in Rocky Mount, Virginia (the "Bank").⁷ The Bank has placed two conditions in the loan commitment that must be satisfied before the Bank will make the loan. First, the Commission must approve the Company's rate increase that went into effect in March 1999. Second, the Company must enter into a contract/agreement with the Town of Rocky Mount for the Town to purchase the Company's Franklin Heights water system at an amount equal to or greater than the loan amount, or the Town must agree that the Company will be the sole supplier of water to Franklin Heights for the ten-year life of the loan. The two conditions obviously relate to the Company's ability to repay the loan. The Company's requested rate increase includes sufficient revenue to repay the loan. The announced annexation of Franklin Heights by the Town of Rocky Mount precipitated the second condition. Franklin Heights accounts for 60% of the Company's customers. If the Town does as it has announced and constructs a parallel water system, the Company's ability to repay the loan may be severely impacted.

The Staff's stated position is any rate increase should not include any monies for the water treatment facility until the facility is constructed and placed in service. If the Commission adopted the Staff's position, I am certain the facility would never be built. The Company would fail to meet

⁷ The interest rate on the loan is fixed for three years.

the Bank's first loan condition, and the Bank would refuse to make the loan to the Company. Simply put, how do you build a water treatment facility if you have no money, or better yet, how can the Commission find the Company in violation of its Order of Settlement if it is financially impossible for the Company to comply with the order? I believe the Commission should approve the Company's requested rate increase. The Company's customers in Long Island Estates have lived with substandard water for far too long and the Commission should do everything within its power to facilitate the construction of a water treatment facility to improve the quality of their drinking water. In order to protect the interests of the Company's customers, the Commission should require the Company to place certain safeguards in effect to ensure any revenue increase granted above the Staff's recommended revenue requirement of \$41,274 is used for the water treatment facility.

If the Commission approves a rate increase for the Company which includes the costs associated with the water treatment facility, the Staff calculated a total annual revenue requirement for the Company of \$69,132. This amount includes the estimated debt service and annual operation and maintenance expenses for the water treatment facility. The difference between \$69,132 and the Staff's recommended revenue requirement is \$27,858. This amount represents the Staff's estimated annual increase in revenue required to fund the water treatment facility. The Company estimated the annual cost of debt service on the loan to be \$12,031 and estimated the annual operating expense to be \$14,524, or a total of \$26,555. In comparing the Staff's additional revenue requirement with the Company's estimated expenses, it can be seen the two are relatively close.⁸ I find an annual revenue requirement of \$69,132 is reasonable to cover the Company's operating expenses and the expenses related to the water treatment facility. This revenue requirement produces an 11.31% return on rate base, which I find is reasonable. I further find the increase in annual revenue should be effective March 9, 1999.

In order to move the water treatment facility project forward, while at the same time protecting the interests of the Company's customers, the Commission should require the Company to establish an escrow account, preferably at First Virginia Bank.⁹ The escrow account would be used solely to pay expenses related to the construction, operation and maintenance of the facility. Expenses related to the Long Island Estates water system or any of the Company's other water systems could not be paid out of the escrow account. The Commission should require the Company to deposit the pro rated sum of \$1,779.81 for the month of March 1999, and the sum of \$2,321.50 (\$27,858 ÷ 12 mos.) for each month thereafter, into the escrow account. Prospectively, the Commission should require the escrow account deposits to be made on or before the 10th day of each month.

Although the Bank's first loan condition may be satisfied in this case, the Bank's second loan condition may preclude the Company from proceeding with the water treatment facility. The Bank has stated that it will not make the loan to the Company unless the Company enters into a contract/agreement with the Town of Rocky Mount for the Town to purchase the Company's Franklin Heights water system at an amount equal to or greater than the loan amount, or the Town

⁸ Depreciation and taxes other than income taxes account for the difference.

⁹ If possible, the escrow account should be an interest bearing account.

must agree that the Company will be the sole supplier of water to Franklin Heights for the ten-year life of the loan. The burden is on the Company, not the Commission, to satisfy one of these conditions. The Company has a certificate of public convenience and necessity issued by the Commission to provide water service to Franklin Heights. The Town of Rocky Mount is a municipality that is not subject to Commission jurisdiction. There are three possible courses of action available to the Town. First, the Town may agree to let the Company continue to be the exclusive provider of water to Franklin Heights, in which case the second loan condition would be satisfied. Second, the Town may move to condemn the Company's Franklin Heights water system, in which case the Commission would hear the case pursuant to Section 25-233 of the Code of Virginia. If the Commission approved the condemnation of the Company's Franklin Heights water system, the Company and the Town would be free to negotiate a price for the system that satisfies the second loan condition. Third, the Town may attempt to construct a parallel water system in Franklin Heights, in which case the Town may expose itself to possible adverse legal proceedings. The Company may have to take legal action to protect its Franklin Heights water service franchise. The Virginia Supreme Court has held that a Commission issued certificate of public convenience and necessity is a property right. *Town of Culpeper v. VEPCO*, 215 Va. 189, 194, 207 S.E.2d 864, 868 (1974). As such, the Company may move a Circuit Court with jurisdiction over the parties to enjoin the Town from taking a property right without just compensation. It is unclear on this record whether such an injunction would satisfy the Bank's second loan condition.

It may take some time for the Company and the Town to resolve the Bank's second loan condition. The Commission should allow the Company eight months from the date of its order in this case to resolve the Bank's second loan condition. If the Company is unable to satisfy the second loan condition and the Bank refuses to make the loan, the Commission should require the Company to file an application for a rate decrease and the Commission should further require the Staff's recommended individual rates be placed in effect on an interim basis. In the interim, the Company is incurring expenses related to the water treatment facility. The Company should be permitted to pay all reasonably incurred expenses related to the construction of the water treatment facility from the escrow account. Such expenses would include the engineering fees and the cost of the drawdown test incurred by the Company. After such expenses have been paid and the Staff has had an opportunity to audit the account, the Commission should require a pro rata refund of all monies remaining in the escrow account. In order to effect the action set forth herein, the Commission would have to retain jurisdiction over this case.

If the Company is able to meet the Bank's second loan condition and the Bank makes the loan to the Company, the Commission should require the Company to submit annually an application to the VDH Drinking Water Revolving Fund Program. If the Company somehow qualifies for a low interest loan, the Company would be in a position to effect a debt swap and lower the interest rate it would be paying on borrowed funds. The Commission should also require the Company to file a quarterly report, including supporting documentation, with the Staff showing all deposits into and disbursements from the escrow account. Finally, the Commission should require the Staff to conduct an annual audit of the escrow account.

The next issue facing the Commission is the Company's rate design. The Company proposed a two-tiered single-tariff rate design. The Staff discussed the advantages and disadvantages of two potential rate designs. The first is a three-tiered single-tariff rate design and

the second is a three-tiered dual-tariff rate design. I find the Staff's proposed three-tiered rate design to be preferable to the Company's proposed two-tiered rate design. The three-tiered rate design should promote greater water conservation and should address the Company's capacity problems. In addition, the three-tiered rates proposed by the Staff shift more of the Company's rate increase from the minimum use customers to the higher use customers. The Commission should approve the following three-tiered single-tariff rates and they should be made effective on the first day of the month immediately following the Commission's order in this case:

	<u>Monthly Rate</u> ¹⁰
First 3,000 gallons	\$13.60
3,001-8,000 gallons, per 1,000 gallons	\$6.50
Over 8,000 gallons, per 1,000 gallons	\$9.00

The Commission should not adopt a three-tiered dual-tariff rate design. The record in this case indicates that each of the water systems has a different cost of service and there has been cross subsidization between the various systems. In the past, the residents of Long Island Estates subsidized the cost of hauling water to Alton Park and Franklin Heights in their rates. The Company's customer base is too small to distinguish between various classes of customers. Utility plant improvements and operations and maintenance expenses should be spread equally among all of the Company's customers.

The Staff also expressed some concern that the final cost of the facility has not been determined. Therefore, the Commission should not grant the Company's proposed rate increase. The estimated cost of the facility has ranged from a low of \$50,000 to a high of \$99,000. There is one thing that is absolutely certain in this case. The Bank has only committed to loan the Company \$80,000. This is the amount the Company requested to recover in its rate increase. If additional funds are required to complete the facility, the Company could collect the two loans it made that are currently outstanding. If the Company borrows less than \$80,000 from the Bank, the additional revenue generated by the rates approved in this case could be used to pay off the loan early. The escrow account established in this case would not allow for those funds to be used for any other purpose.

As to the general recommendations made by Staff witnesses Armistead and Abbott, I find the Company should either collect the two \$4,000 no-interest loans or charge the borrowers a competitive market interest rate on the loans. The Company should not be a source of free financing for its president or his family. I further find the Company should transfer a prepaid water main extension from its prepaid account to CIAC. It is clear on the record that the prepayment is now the property of the Company. I further find the Commission should require the Company to maintain its books in accordance with the Uniform System of Accounts for Class "C" Water Utilities. The Company's president is an accountant and he should be able to accomplish this with little or no difficulty. I further find that the Company should depreciate plant and amortize contributions at a three percent composite rate in accordance with the Commission's decision in

¹⁰ The individual monthly rates were calculated by the Staff to generate the \$69,132 in annual revenue recommended in this Report.

Case No. PUE870037. I further find the evidence fails to support the Company's request for an increase in its service connection charge. Therefore, the charge should remain at \$475. I agree with the Staff that the Company should change the rates in its tariff from monthly to bimonthly to coincide with its bimonthly billing cycle. This will eliminate the possibility for customer confusion when they receive their water bills, and this will further ensure the Company is collecting the correct revenue from its customers. Finally, I find the Company should clearly state in its tariff the methodology used to calculate the rates that apply to multi-unit connections. The Company's current methodology appears reasonable. However, it should be stated in the Company's tariff.

FINDINGS AND RECOMMENDATIONS

Based on the evidence received in this case, and for the reasons set forth above, I find that:

- (1) The use of a test year ending August 31, 1998, to determine the Company's income and expenses is reasonable;
- (2) An annual revenue requirement of \$69,132 is reasonable to cover the Company's current operating expenses and the expenses related to the construction, operation and maintenance of the water treatment facility;
- (3) The Company's annual revenue increase should be made effective March 9, 1999;
- (4) Based on annual revenues of \$69,132, the Company's rate of return on rate base of 11.31% is reasonable;
- (5) The Commission should require the Company to establish an escrow account to be used solely for the payment of expenses related to the construction, operation and maintenance of a water treatment facility for the Long Island Estates subdivision in Franklin County, Virginia;
- (6) The Commission should require the Company to deposit into the aforesaid escrow account the pro rated sum of \$1,779.81 for the month of March 1999, and the sum of \$2,321.50 for each month thereafter, up to and including the month the Commission enters its order in this case, to cover the expenses related to the water treatment facility;
- (7) Beginning the month after the Commission enters its order in this case, and each month thereafter, the Company shall deposit the sum of \$2,321.50 into the escrow account on or before the 10th day of the month;
- (8) The Commission should allow the Company eight months from the date of its order to resolve the Bank's second loan condition;

- (9) If the Company fails to satisfy the Bank's second loan condition, the Commission should:
- (a) order the Company to file an application for a rate decrease;
 - (b) order the Company to place the Staff's recommended individual rates into effect on an interim basis;
 - (c) permit the Company to pay all reasonably incurred construction expenses related to the water treatment facility out of the escrow account;
 - (d) require the Staff to audit the escrow account; and
 - (e) order a pro rata refund of all monies remaining in the escrow account.
- (10) The Commission should require the Company to file annually with the VDH an application for a loan under the Drinking Water Revolving Fund Program;
- (11) The Commission should require the Company to file a quarterly report, including supporting documentation, with the Staff showing all deposits into and all disbursement from the escrow account;
- (12) The Commission should require the Staff to conduct an annual audit of the Company's escrow account;
- (13) The Commission should approve the following three-tiered single-tariff rates and make them effective on the first day of the month immediately following the Commission's order in this case:

	<u>Monthly Rate</u>
First 3,000 gallons	\$13.60
3,001-8,000 gallons, per 1,000 gallons	\$6.50
Over 8,000 gallons, per 1,000 gallons	\$9.00

- (14) The Company should either collect the two \$4,000 no-interest loans, or charge the borrowers a competitive market interest rate on the loans;
- (15) The Company should transfer a prepaid water main extension from its prepaid account to CIAC;
- (16) The Company should be required to maintain its books in accordance with the Uniform System of Accounts for Class "C" Water Utilities;

- (17) The Company should depreciate plant and amortize contributions at a three percent composite rate in accordance with the Commission's decision in Case No. PUE870037;
- (18) The Company's request for an increase in its service connection charge should be denied;
- (19) The Company should change the rates in its tariff from monthly to bimonthly to coincide with its bimonthly billing cycle; and
- (20) The Company should clearly state in its tariff the methodology used to calculate the rates for multi-unit connections.

I therefore **RECOMMEND** the Commission enter an order that:

- (1) **ADOPTS** the findings contained in this Report;
- (2) **GRANTS** the Company an annual revenue requirement of \$69,132; and
- (3) **RETAINS** jurisdiction of this case to effect such other and further relief as may be appropriate.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and Commission Rule 5:16(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

Michael D. Thomas
Hearing Examiner